Labrador Iron Mines Holdings Limited

(LIM-T C$8.55)

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Rating: 1-Sector Outperform | **Target** 1-Yr: C$15.00 | **ROR** 1-Yr: 75.4% | **Est. NTM Div.** C$0.00

Risk Ranking: Caution Warranted | 2-Yr: C$15.00 | 2-Yr: 75.4% | **Div. (Current)** C$0.00

Valuation: 0.9x NAV (8%) | **Yield** 0.0%

Key Risks to Target: Commodity price, operating and technical risks, environmental and legal risks

Site Visit Highlights Progress and Challenges

Event

- We visited Labrador Iron Mines' James mine and Silver Yards beneficiation plant on August 25, 2011.

Implications

- **Mining operations are going well.** Labrador Iron Mines is targeting to declare commercial production at the James mine and Silver Yards beneficiation plant on October 1, 2011.
- **First sales expected in early September.** Labrador Iron Mines has reached an agreement with Rio Tinto for 2011, where IOC will ship LIM ore through its Sept-Îles port. Rio Tinto will use its "best efforts" to sell LIM ore alongside Rio Tinto's own direct shipping ore.
- **Several options for future shipping and sales.** In calendar 2012 and beyond, Labrador Iron Mines has several options to get its ore to market, including an extension to its agreement with Rio Tinto, shipping from the company's own ports, or an agreement with another local miner such as Cliffs Natural Resources.

Recommendation

- We maintain our 1-Sector Outperform rating at this time; however, our target price decreases to C$15.00 per share from C$16.00 per share and our NAVPS estimate decreases to C$16.56 from C$17.83.

Capitalization	
Shares O/S (M)	53.9
Total Value ($M)	460.5
Float O/S (M)	21.7
Float Value ($M)	185.5
Next Reporting Date	Nov-11

Qtly Adj EPS (FD)	Q1	Q2	Q3	Q4	Year	P/E
2010A	$-0.01 A	$-0.01 A	$0.06 A	$-0.01 A	$0.03	n.m.
2011A	$-0.01 A	$-0.02 A	$-0.02 A	$-0.03 A	$-0.09	n.m.
2012E	$-0.09 A	$-0.02	$0.18	$0.08	$0.15	57.00
2013E	$0.32	$0.59	$0.11	$-0.02	$1.00	8.55

(FY-Mar.)	2009A	2010A	2011A	2012E	2013E
Adj Earnings/Share	$-0.01	$0.03	$-0.09	$0.15	$1.00
Cash Flow/Share	$-0.01	$-0.06	$-0.08	$0.18	$1.04
Price/Earnings	n.m.	n.m.	n.m.	57.8	8.5
Revenues	$0	$0	$0	$77	$218
EBITDA	$-2	$-3	$-5	$15	$78
Current Ratio	42.9	21.1	5.1	2.5	2.1

IBES Estimates		
EPS 2012E: $0.69	BVPS12E	$5.34
EPS 2013E: $1.65	NAV	$16.56
	P/NAV	0.52x

Historical price multiple calculations use FYE prices. Source: Reuters; Company reports; Scotia Capital estimates.

Pertinent Revisions

	New	Old
Target:		
1-Yr	$15.00	$16.00
2-Yr	$15.00	$16.00
EPS12E	$0.15	$0.48
EPS13E	$1.00	$0.95

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A Promising Start

- **Mining operations are going well.** Labrador Iron Mines highlighted the mining operations at the James mine in Schefferville. As illustrated in Exhibit 1, mining operations are progressing well. Labrador Iron Mines has been mining at the James mine since June, commissioning activities at the Silver Yards beneficiation plant are proceeding as planned, and the first train loaded with ore departed for the Sept- Îles port on June 29, 2011.
- **Commercial production is targeted for October 1, 2011.** Labrador Iron Mines is targeting to declare commercial production at the James mine and Silver Yards beneficiation plant on October 1, 2011. The "commercial production" milestone means that revenues, operating costs, and depreciation expenses are recognized as income and expenses, rather than capitalizing the items. However, if first sales are completed in September, the company might declare commercial production in late fiscal Q2/12 as per IFRS.
- **Modular expansion continues.** Phase 1 (1.0Mtpa washing and screening facility) of the Silver Yards beneficiation plant is completed, and Labrador Iron Mines expects to finish Phase 2 (increase capacity to 1.5Mtpa) in early September. Although the Phase 3 expansion (increase capacity to 2.5Mtpa) has not yet been formally approved, we expect construction will go ahead in calendar 2012 at a cost of approximately C$35 million, and that full production run rates will be achieved at Silver Yards in calendar 2013.
- **Updating our long-term assumptions to reflect new information.** Labrador Iron Mines outlined plans to build its second process plant at the Redmond mine. Construction is expected to start in calendar 2012 for production start-up in calendar 2013. Mining operations at the Houston deposit are expected to start in late calendar 2014, and Houston ore will be processed at the Redmond plant (we had previously assumed that Houston ore would be processed at the Silver Yards beneficiation plant). See Exhibit 4 for a summary of our production ramp-up assumptions.

Exhibit 1 – Mining Operations at James Mine (August 2011)

Source: Scotia Capital.

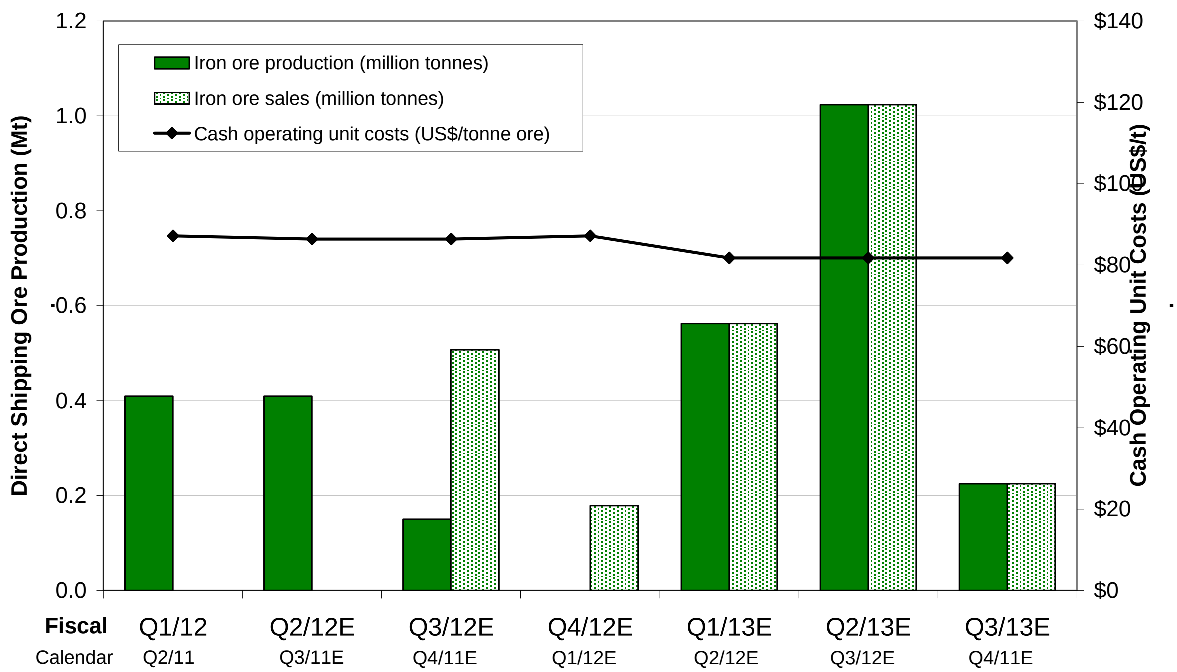
Exhibit 2 – Silver Yards Beneficiation Plant (August 2011)

Source: Scotia Capital.

Exhibit 3 – Iron Ore Stockpile at the Silver Yards Beneficiation Plant (August 2011)

Source: Scotia Capital.

Exhibit 4 – Labrador Iron Mines Production Profile



Source: Company reports; Scotia Capital estimates.

Sales Are the Next Hurdle

- **Rio Tinto agreement expected to yield sales in the near term.** Labrador Iron Mines has signed an agreement with Rio Tinto, where Rio Tinto will sell LIM iron ore through the Iron Ore Company of Canada (majority owned and operate by Rio Tinto) port in Sept-Îles. The specific terms of the agreement have not been disclosed; however, we expect that the costs to Labrador Iron Mines are significant. For this reason, we have reduced our realized price assumptions for calendar 2011 to 77% of the benchmark price (from 97% previously), increasing to 87% of benchmark in calendar 2012 as we assume Labrador Iron Mines will sign a lower-cost sales agreement for next year.
- **Agreement provides access to Rio Tinto resources.** The Rio Tinto agreement provides Labrador Iron Mines with access to Rio Tinto's sales network. Rio Tinto will use its "best efforts" to sell LIM ore alongside Rio Tinto's own direct shipping ore from its Singapore office. Also, the Labrador Iron Mines ore will be shipped from IOC's deepwater port, which is able to load capesize vessels, whereas LIM's own Pointe aux Basques and Cliffs Natural Resources' Pointe Noire facilities may only load smaller Panamax vessels. LIM estimates that the use of capesize vessels could save approximately $10-$12/t in transportation costs.
- **Future sales agreement is still uncertain.** The current agreement with Rio Tinto is only valid for calendar 2011. In calendar 2012 and beyond, Labrador Iron Mines has several options to get its ore to market; see below for a discussion on the three most likely alternatives. We note that none of the options below is perfectly ideal, and all will require trade-offs.
    - **Renew the agreement with IOC.** Although the current sales agreement provides LIM with access to Rio Tinto resources, we believe the agreement is

also costly. In addition, we are not certain that Rio Tinto will agree to renew the current agreement into calendar 2012, depending on Rio Tinto's own expansion plans at the Iron Ore Company of Canada.

- **Ship from LIM's own dock at Pointe aux Basques.** While utilization of Labrador Iron Mines' own terminal would reduce the selling costs, LIM would incur higher shipping costs and would be responsible for marketing and selling its own product.
- **Reach an agreement with Cliffs Natural Resources.** We believe that Labrador Iron Mines could ship its ore via Cliffs Natural Resources' Pointe Noire port. While the sales costs might be lower than the current Rio Tinto agreement, shipping charges would be higher as Cliffs must use trans-shipping methods to load capesize vessels. We also note that Cliffs' capacity to handle third-party ore might be reduced following the company's acquisition of Consolidated Thompson and the organic expansion plans at Bloom Lake.

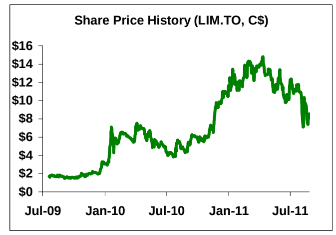
Valuation

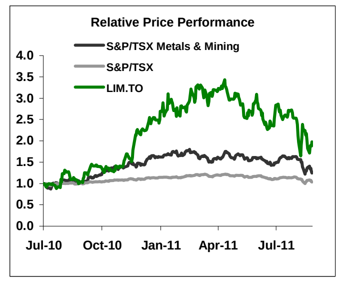
- **We maintain our 1-Sector Outperform rating at this time; however, our target price decreases to C$15.00 per share** from C$16.00 per share. Our NAVPS estimate decreases to C$16.56 from C$17.83 as a result of a number of changes to our model which reflect Labrador Iron Mines' most recent guidance.
- Please see Exhibit 5 for a valuation summary.

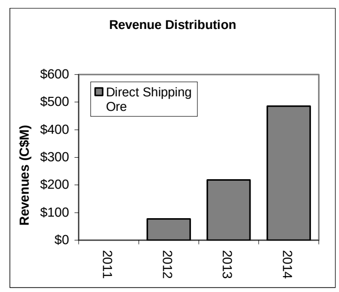
Exhibit 5 - Labrador Iron Mines Valuation Summary

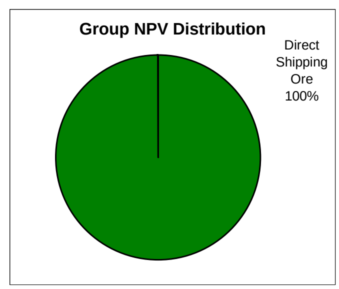
Labrador Iron Mines (LIM.TO)	Q1/12A	Q2/12E	Q3/12E	Q4/12E	2011A	2012E	2013E	2014E
calendar	Q2 2011	Q3 2011	Q4 2011	Q1 2012				
Share data and financial ratios								
Shares outstanding - FD, weighted average (millions)	51	54	54	54	44	54	54	54
Market capitalization, EOP (C$ millions)	$622	$466	$466	$466	$598	$466	$808	$808
Enterprise value, EOP (C$ millions)	$561	$414	$415	$427	$518	$427	$779	$632
Adj. net earnings per share - FD (C$)	($0.09)	($0.02)	$0.18	$0.08	($0.09)	$0.15	$1.00	$2.82
Operating cashflow per share - FD (C$)	($0.08)	($0.02)	$0.18	$0.09	($0.08)	$0.18	$1.04	$2.90
Net free cashflow per share - FD (C$)	($0.50)	($0.19)	($0.02)	($0.23)	($0.43)	($0.91)	($0.18)	$2.75
Book value per share - FD (C$)	$5.39	$5.07	$5.25	$5.34	$3.97	$5.34	$6.36	$9.17
Dividend per share (C$)	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Price/Earnings					n.m.	58.5	15.0	5.3
Price/Cash flow					n.m.	48.9	14.4	5.2
EV/EBITDA					n.m.	29.3	10.0	2.9
EBITDA margin					n.m.	0.2	0.4	0.4
Net debt/[Total Debt + Equity]					(0.5)	(0.1)	(0.1)	(0.4)
ROE					-2%	3%	16%	31%
Dividend yield					0%	0%	0%	0%
Key operating parameters								
Iron ore production (million tonnes)	0.2	0.2	0.3	0.1	0.04	0.86	1.81	3.69
Iron ore sales (million tonnes)	0.0	0.0	0.5	0.2	0.00	0.69	1.81	3.69
Benchmark iron ore Hamersley fines price (UScents/dmtu	$279	$275	$250	$230	$201	$259	$221	$195
USD/CAD	1.03	1.08	1.08	1.09	0.98	1.09	0.96	0.96
Average realized price (US$/tonne)	$0	$0	$118	$134	$0	$120	$127	$126
Unit cost of goods sold (US$/tonne)	$0	$0	$86	$87	$0	$88	$79	$67
Income statement (C$ millions)								
Revenues	$0	$0	$55	$22	$0	$77	$218	$485
Operating costs	$0	$0	$41	$14	$0	$55	$136	$259
EBITDA	($4)	($1)	$14	$7	($5)	$15	$78	$217
Depreciation and amortization	$0	$0	$0	$0	$0	$1	$1	$3
General and administration	$1	$1	$1	$1	$4	$3	$4	$8
Other operating expenses	($4)	($0)	($0)	($0)	($1)	($5)	($1)	($1)
Operating earnings	($5)	($1)	$14	$7	($5)	$14	$77	$214
Interest income (expense)	$0	$0	$0	$0	$0	$0	$0	$0
Other income (costs)	$0	$0	$0	$0	$1	$0	$0	$0
Total taxes	$0	$0	$4	$2	($1)	$6	$23	$62
Net Earnings	($5)	($1)	$9	$4	($4)	$8	$54	$152
Adj. Net Earnings	($5)	($1)	$9	$4	($4)	$8	$54	$152
Cash flow statement (C$ millions)								
Operating cashflow	($4)	($1)	$10	$5	($4)	$9	$55	$156
Cash from operating activities	($4)	($1)	$10	$5	($3)	$9	$55	$156
Cash from investing activities	($31)	($9)	($11)	($17)	($39)	($67)	($66)	($8)
Cash from financing activities	$115	($1)	$0	$0	$2	$114	$0	$0
Increase (decrease) in cash	$80	($10)	($1)	($12)	($41)	$56	($11)	$148
Net free cashflow	($25)	($10)	($1)	($12)	($19)	($49)	($10)	$148
Balance sheet (C$ millions)								
Cash and cash equivalents	$88	$77	$76	$64	$8	$64	$54	$201
Other current assets	$3	$3	$3	$3	$2	$3	$3	$3
Long-term assets	$215	$224	$235	$252	$215	$252	$316	$321
Net debt	($61)	($52)	($51)	($39)	($80)	($39)	($29)	($176)
Total debt and capital lease obligations	$2	$1	$1	$1	$2	$1	$1	$1
Other liabilities	$30	$30	$30	$30	$49	$30	$30	$30
Shareholder equity	$274	$273	$283	$287	$174	$287	$342	$494

August 26, 2011









Net Asset Value	8%	10%
Direct Shipping Ore	$878	$765
Exploration properties	$0	$0
Equity investments	$0	$0
Working capital	$52	$52
Total debt and capital leases	($1)	($1)
Reclamation Obligations	$0	$0
Corporate SG&A	($37)	($32)
TOTAL NAV	**$892**	**$784**
NAVPS	**$16.56**	**$14.56**

Sensitivity	EPS	CFPS	NAVPS
fiscal 2012			
Iron Ore	31%	29%	36%
USD/CAD	-28%	-26%	-28%

Reserves/Resources (Mt)	
Measured & Indicated	39.6
Inferred	1.3

Rating and Target	
Rating	1-Sector Outperform
Risk ranking	Caution warranted
Valuation method	0.9x NAV (8%)
1-yr Target	C$15.00
Share price	C$8.55
ROR	75%

Source: Company reports; Reuters; Scotia Capital estimates.

SC Online Analyst Link

Appendix A: Important Disclosures

Company	Ticker	Disclosures (see legend below)*
Labrador Iron Mines Holdings Limited	LIM	G, I, P, T, U

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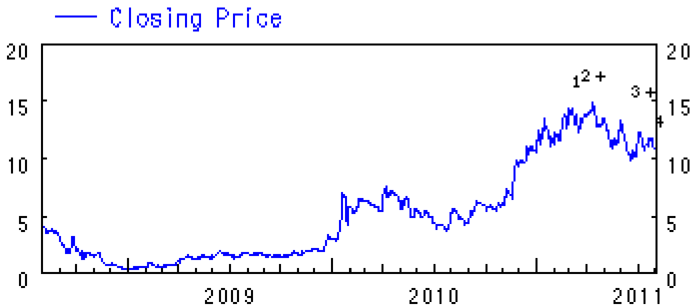

Labrador Iron Mines Holdings Limited				
#	**Date**	**Closing Price**	**Rating**	**Target-1YR**
1	17-Mar-11	$12.65	* 1-Sector Outperform	*$20.00
2	6-Apr-11	$14.20	Restricted	Restricted
	27-Apr-11	$13.46	* 1-Sector Outperform	*$18.50
3	4-Jul-11	$12.35	1-Sector Outperform	*$17.75
	29-Jul-11	$10.93	1-Sector Outperform	*$17.50
4	22-Aug-11	$7.40	1-Sector Outperform	*$16.00

* represents the value(s) that has changed.

Numbers are located to the left of the lines they represent.
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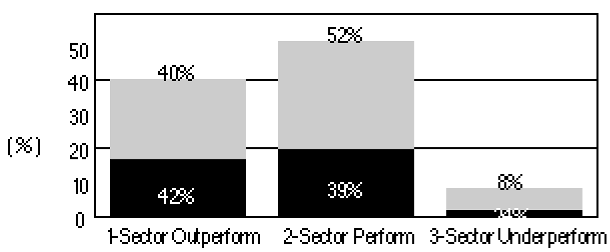

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